FACULTY OF LAW
Lund University

Þráinn Pálsson

Do the Board Neutrality rule and the Breakthrough rule provide for a level playing field in Takeovers in the EU?

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Contents

1. Abbreviations and Glossary

Abbreviations

AoA	Articles of Association
BNR	Board Neutrality Rule
BTR	Breakthrough Rule
CEPS	Centre for European Policy Studies
CEM	Control-enhancing mechanisms
ECJ	European Court of Justice
OSOV	One share one vote
TFEU	Treaty on the Functioning of the European Union
US	United States of America

Glossary

The high-level group of experts	the High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union
Offeree company	A company, the securities of which are subject to a bid
Offeror	Any natural or legal person governed by public or private law making a bid
Management	The body responsible for managing a company, e.g. board of directors.
Securities	Transferable securities carrying voting rights, used interchangeably with shares in this paper
Takeover Directive	Directive 2004/25/EC on takeover bids OJ L 142/12

2. Introduction to Paper

2.1. Company law in the European Union

Attempts to harmonize company law in the European Union has gradually been done in stages, starting with the so-called first directive (First council directive 68/151/EEC), which was approved in 1968.[1] The EU states that its mission in this area is to enable businesses to be set up and carry out their operations throughout the Union, to provide protection for shareholders and other parties with interest in companies, make business more efficient, competitive and sustainable and to encourage business to cooperate across state borders within the Union.[2] To achieve this goal, the EU has enacted a number of legislations, one of which is the 13th company directive/Takeover Directive.[3]

2.2. Aim of Thesis

The subject of this paper is to evaluate if the Takeover Directive truly provides for a level playing field in takeovers, particularly if article 9 (the board neutrality/no frustration rule) and article 11 (the breakthrough rule) can be considered adequate measures to that end. These rules have been the centre of much controversy both before and after adoption and this paper aims to evaluate if these two articles have been successful in the protection of shareholders and facilitation of takeovers in the European Union via levelling the playing field. Both in terms of effect, and since those articles were made optional, transposition (or lack thereof) into national law. Should the Takeover Directive be weight and found wanting, suggestions on how better it might achieve the goals will be offered.

2.3 Methodology and Material

In order to investigate if a true and level playing field has been achieved by articles 9 and 11 of the Takeover Directive, I will mostly use reports from the Institutions of the EU, namely the Commission.[4] As well as to dig in to the source material they commissioned and used in order to generate said reports, namely the report of the High level group of company lawyers experts in company law [5] and the *External Study* conducted by Marcus partners.[6] To get as wide a vantage as possible I'll also rely on articles and pieces done by experts in the field so as to able to come to

an unbiased conclusion.

2.4. Delimitation

The two main objectives of the directive were to give a legal framework for takeover activity in the European Union and to ensure that minority shareholders would be afforded a minimum level of protection which could be equivalent throughout the Union, in other words, to level the playing field.[7]

This paper will focus solely on the legal aspects of the suggestions set out by the High-level group of experts in their report regarding articles 9 and 11, picked up in the Takeover Directive, which they believed would be necessary in order to level the playing field and ensure the protection of shareholders, these being the Board Neutrality rule and the Breakthrough rule.[8] It will not focus on the positive or negative socioeconomic aspects following the adoption and transposition of the Takeover Directive or other any other aspects contained within that are unrelated to articles 9 and 11. As the Takeover Directive

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[4] European Parliament (EU), 'REPORT on the Application of Directive 2004/25/EC on Takeover Bids' A7-0089/2013', 23 March 2013 <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A7-2013-0089+0+DOC+XML+V0//EN&language=en> accessed 2 April 2019. &
Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012.

[5] Winter, Jaap W. and Schans Christensen, Jan and Garrido Garcia, José M. and Hopt, Klaus J. and Rickford, Jonathan and Rossi, Guido and Simon, Joelle, Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union (January 10, 2002). REFORMING COMPANY AND TAKEOVER LAW IN EUROPE, G. Ferrarini, K. J. Hopt, J. Winter, E. Wymeersch, eds., Annex 2, pp. 825-924, Oxford (Oxford University Press) 2004. Available at SSRN: https://ssrn.com/abstract=315322 or http://dx.doi.org/10.2139/ssrn.315322 : hereafter cited as; Report of The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union

[6] Clerc, Christophe, et al. *A Legal and Economic Assessment of European Takeover Regulation.* Brussels, Belgium: Centre for European Policy Studies, 2012.

[7]Commission (EU), proposal for a directive of the European Parliament and of the council on takeover bids, COM (2002) 543 final. 2.September.2002. p. 31

[8] Report of The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union p. 18-44

states, it only applies to takeovers of companies that have some or all of their securities admitted to trading on regulated markets[9] in one or more Member States.[10]

A hostile takeover is where management of the offeree company is opposed to the proposed takeover and since articles 9 and 11 of the Takeover Directive are solely focused on pre and post bid defences only hostile takeovers shall be considered in this paper as it is unlikely that those rules should be enacted in case of a friendly takeover.[11]

2.5. Outline of Chapters

Chapter 2 sets out the scope of the thesis, narrowing down what will be covered and excluding what will not, Chapter 3 will briefly explore the political landscape in which the gave rise to the Takeover Directive as well as examining the history of its adoption. Furthermore, chapter 3 will examine the aims of the Takeover Directive which the articles examined in this paper were supposed to achieve. Chapter 4 will examine the Board Neutrality rule, at first its functional properties, second, the reasoning behind its implementation and lastly, explore some of the controversies that have risen in connection to the rule. It will also look how well it was transposed by the Member States. Chapter 5 will follow the structure of chapter 4 except regarding the Breakthrough Rule. Chapter 6 will then look into the optionality of the rules in as allowed for by article 12 of the Takeover Directive and the reciprocity rule contained therein as well. Article 12 is an intricate addition to the legal landscape but paramount to achieve a level playing feel and as such need's examination. Chapter 7 will entail concluding remarks, explore if the Takeover Directive has succeeded in its task to afford protection to shareholders and levelling the playing field and add suggestions for improvement should the rules be found wanting. Chapter 8 lists the source material for the thesis and chapter 10 is a small appendix for reference throughout the thesis.

[9] Article 4(21) Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014
[10] Article 1(1) of the Takeover Directive
[11] Donato Romano; Stefano Casamassima, European Directive 25/2004/EC and the Rules on Defenses in Takeover Bids, 7 Bocconi Legal Papers 73 (2016) p. 74

3. The Takeover Directive

3.1. Benefits of takeovers

A successful takeover bid can and more often than not will have benefits to the target company, at least if share value is used as an indicator. Multiple studies, spanning the last decades in the US and the United Kingdom have shown that premiums on shares in successful hostile takeovers are on average 30 per cent higher than nominal market value and 18 per cent higher on average in non-hostile takeovers.[12] This increase in value can be accomplished by allocating resources more efficiently, but a market with a healthy takeover culture may also enhance corporate governance as management is held more accountable and indecencies are punishable, e.g. by removal of board members or by a takeover. As stated, efficiency gains directly improve the target company's vitality while the mere presence of a possible takeover bid will keep the company's managers on their toes as a change of control often follows a successful takeover bid, especially in cases of hostile takeovers.[13] A well-functioning takeover market fostering good corporate governance is therefore beneficial as a whole and the Takeover Directive recognises that a Community-wide clarity is needed in order to prevent distortion in company governance resulting from discrepancies in the takeover cultures of the Member States.[14]

3.2. Aim of the Directive

Attempts to harmonize rules on takeovers in the European Union are as old as the single market project itself. [15] The fact that the Takeover Directive is also dubbed the 13th company directive indicated that this is an ongoing project in the wider harmonization of

[12] W. CAI, <Anti-Takeover Provisions in China, How Powerful Are They**,** in Company and Commercial Law Review, n. 22, 2011, pp. 311-317,
[13] Donato Romano; Stefano Casamassima, European Directive 25/2004/EC and the Rules on Defenses in Takeover Bids, 7 Bocconi Legal Papers 73 (2016) p. 73-75
[14] Recital 3, The Takeover Directive
[15] Dimity Tuchinsky, 'The Takeover Directive and Inspire Art Reevaluating the ...' (June 2007) <http://www.nylslawreview.com/wp-content/uploads/sites/16/2013/11/51-3.Tuchinsky.pdf> accessed March 28, 2019 p. 696

company law in the EU.[16] The Commission, in its proposal for the directive, noted that the difference in the takeover and corporate culture between the Member States in the European Union was far too vast to be able to facilitate a harmonized and healthy takeover market.[17] Thus, there were a number of factors behind the Takeover Directive such as to create a takeover market whereby takeovers would be more easily facilitated, especially cross-border ones, to improve legal certainty, protection of shareholders' interests, reinforce the single market and make it more competitive internally and externally. These objectives were to be achieved by creating a more homogeneous takeover market. The protection of employees was also noted as an important goal of the Takeover Directive but is not the subject of this particular paper.[18],[19] Instead, it shall focus on the protection of shareholders' interests via levelling the playing field as it is a primary objective of the Takeover Directive according to the Commission.[20] The Takeover Directive states that shareholder protection and a Union-wide clarity in takeover matters is a necessity, if a level playing field would be achieved, whereby shareholders would be protected by certain safeguards, it is likely that it would have a spillover effect further aiding in accomplishing the other objectives.[21] A highly plausible scenario is that the Commission wanted to challenge the United States dominance in the global capital marketspace by creating a capital market in Europe that might one day rival the one across the pond.[22]

3.3 Historical Background

The Takeover Directive as we know it today has a long history leading up to its adoption and transposition. A history filled with special interests and political compromises

[16] 'Overview of Directives / Company Law / Company Law and CG / Home - WORKER PARTICIPATION.Eu' (date) <https://www.worker-participation.eu/Company-Law-and-CG/Company-Law/Overview-of-Directives> accessed 18 May 2019.
[17]Commission (EU), proposal for a directive of the European Parliament and of the council on takeover bids, COM (2002) 543. 2.10.2002, p. 3,12,35
[18] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, The Takeover Directive as a Protectionist Tool? (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 1-2
[19] REPORT on the Application of Directive 2004/25/EC on Takeover Bids - A7-0089/2013, p.2
[20]proposal for a directive of the European Parliament and of the council on takeover bids, COM (2002) 543. 2.10.2002, p. 31
[21] recital 2,3 of the Takeover Directive
[22] Kecskés A and Halász V, 'Hostile Takeover Bids in the European Union: Regulatory Steps En Route to an Integrated Capital Market' (2014) 109 Revista Brasileira De Estudos Políticos p. 91-92

that some claim to have been more than 30 years in the making.[23] The Commission first put forth a proposal for the takeover directive in 1989. A proposal that was heavily influenced by the favourable economic climate at the time and called for much harmonisation in the field. However, the proposal was met with a magnitude of resistance from the Member States, particularly regarding the mandatory bid rule and (more importantly for this paper) the limitation on the availability of defensive takeover measures. Limitations on the availability of defensive measures is a reference to the requirements of the Board Neutrality Rule, that a shareholder's approval must be granted before any defensive measures are enacted. Following the initial pushback, the Commission put forth a second, more lenient, proposal in 1996. After deliberation between the European Parliament and the Council, a new compromise was put up for a vote in 2001 where the European Parliament rejected the proposal with a split vote, citing the defensive measures as one of the major concerns. Following the rejection by Parliament, the Commission tasked a group of experts[24] to solve the issues put forth by Parliament. This led to the third proposal in 2002 which, after the so-called '*Portuguese Compromise*' became the Takeover Directive, adopted on the 2nd of April 2004 to be transposed no later than by 20th of May 2006. The Portuguese compromise Relates to the Board Neutrality rule and the Breakthrough rule (art. 9,11) of the Takeover Directive. The Member States finally agreed, at the behest of Portugal, that those articles should be made optional on both national and company level with the addition of reciprocity. If a member state allowed reciprocity it meant that a company would not need to apply a rule regularly binding to itself when faced with a company that was not constrained by the same rule or rules. [25]

[23]Wymeersch, Eddy O., The Takeover Bid Directive, Light and Darkness (January 2008). Financial Law Institute Working Paper No. 2008-01. Available at SSRN: https://ssrn.com/abstract=1086987or http://dx.doi.org/10.2139/ssrn.1086987 p. 2-3

[24] The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union

[25] Clers C, *A Legal and Economic Assessment of European Takeover Regulation* (Centre for European Policy Studies 2012) p. 1-2

4. Board Neutrality Rule

The following sub chapters will briefly explain the function of the Board Neutrality Rule and the rationale behind it. Then the most prevalent criticism of the rule will be examined in turn.

4.1. Function

The Board neutrality rule (BNR) is established in article 9(2) of the Takeover Directive and ,in essence, prohibits the management of the offeree company to undertake any action that might frustrate the bid from the time they receive information about an intended bid, though Member States may impose the BNR at an earlier point[26] until the bid is concluded.[27] Perhaps the BNR might be more aptly named the non-frustration rule as the offeree company's board has some powers to act. Both names have been known to be used but for the sake of clarity, this paper shall stick to the BNR naming. The board may hence seek a *White Knight*, i.e. seek alternative takeover offers and are allowed to continue the completion of measures that would be regarded as '*forming part of the normal course of the company's business.'*[28] Should the implementation have, or might have a frustration effect on the bid, a decision from a general meeting of the shareholders would be required.[29]

4.2. Reasoning

The High-level group of experts conceived that in order for the regulation to be able to level the playing field, takeover bids should abide by two principles, one fathered the Board Neutrality Rule (BNR), the other the Breakthrough rule (BTR). The one relating to the BNR was the shareholder decision making principle, i.e. the High-level group of experts believed that in the event of a takeover the ultimate decision about the acceptance or hindrance of a tender bid should reside with the shareholders. The group considered if the Member States should be granted leeway to allow shareholders to give consent for frustrating actions in advance for a limited time period, e.g. 18 months but ultimately

[26] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, The Takeover Directive as a Protectionist Tool? P. 6
[27] Kecskés A and Halász V, 'Hostile Takeover Bids in the European Union: Regulatory Steps En Route to an Integrated Capital Market' (2014) 109 Revista Brasileira De Estudos Políticos p. 114-115
[28] Article 9(3) of the Takeover Directive
[29] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, The Takeover Directive as a Protectionist Tool? P. 3-4

decided against it. The reasoning being that only when a bid has been announced could the shareholders really assess the situation an make an informed decision about a particular takeover bid.[30] It should be noted that even though most Member States require shareholder approval for major decisions within a company, the management is still allowed considerable leeway before the announcement of a takeover bid.[31]

The reason why the High-Level group of experts identifies the shareholders' authority as crucially important is the asymmetrical flow of information between the shareholders and the management of any given company. This mismatch of information is most often dubbed the Principal-Agent problem and manifests itself in a situation when one party (the agent) is making decisions on behalf and to the supposed benefit of another party (the principal). [32] It is no secret that following successful takeovers there is generally a change in management that follows as an industry norm.[33] Thus, the management might have a very conflicting interest to that of the shareholders. The former would like to keep their jobs while the latter would like to maximize their gains by selling at the highest possible price.[34] The Takeover Directive even acknowledges this problem by putting in a provision obligating the management of an offeree company to act in the interest of the company as a whole and to let the shareholders decide on the merits of a bid, that coupled with the BNR is supposed to ensure that the final decision making power lies with the shareholders.[35]

4.3. Controversial Issues

Even though the goal behind the BNR is noble there is far from common census if it is delivering what it sets out to do or even if should. These next sub-chapters explore some of the critics that have been raised regarding the BNR.

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[30] The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union, p. 2-3 & 27-29
[31] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, The Takeover Directive as a Protectionist Tool? (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 6
[32]____ 'The Principal-Agent Problem' (Intelligent Economist*).* January 8, 2018) <https://www.intelligenteconomist.com/principal-agent-problem/> accessed April 1, 2019
[33] Kecskés A and Halász V, 'Hostile Takeover Bids in the European Union: Regulatory Steps En Route to an Integrated Capital Market' (2014) 109 Revista Brasileira De Estudos Políticos p. 110
[34] Donato Romano; Stefano Casamassima, European Directive 25/2004/EC and the Rules on Defenses in Takeover Bids, 7 Bocconi Legal Papers 73 (2016) p. 74
[35] The Takeover Directive, article 3(1.C)

4.3.1 Management mischief

As previously stated, due to the Principal-Agent conundrum, the interests of the management and the shareholders don't always coincide. According to the BNR, the management of the offeree company must draw up a document where it states their opinion on the takeover bid. Including views on the repercussions of the bid on the company, its operations, and employees.[36] The management can thus be tempted to give a bad recommendation to a takeover bid or be persuaded in favour of it.[37]

An example of management influencing would be the so-called *Golden parachute,* which is a very generous severance package. An offeree company might be inclined to include such a provision in its articles of association (AoA) to discourage its management from acting in a self-preserving manner. However, this might prove to be counterproductive whereby management might settle for a lower share price and recommend a bad deal to the shareholders in order to obtain their severance package.[38] Another way for management to act in self-interest would be to abuse the only post-bid takeover defence permitted under the BNR, the *White Knight.*[39]

The *White Knight* defence allows the management to seek alternative takeover bids. The rationale behind it is to encourage competition between bidders which in turn would, or at least should, lead to higher share price for shareholders. Management might, however, be persuaded to act more advantageous to one bidder than another by being more cooperative, disclose more detailed information than it is required to by the Takeover Directive and etc. For example, if said bidder would offer private benefits to the members of management. This could manifest itself in promises for maintaining their office or to be offered another post should their particular takeover bid prevail.[40]

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[36] Article 9(5) of the Takeover Directive
[37] Donato Romano; Stefano Casamassima, European Directive 25/2004/EC and the Rules on Defenses in Takeover Bids, 7 Bocconi Legal Papers 73 (2016) p. 93
[38] Kecskés A and Halász V, 'Hostile Takeover Bids in the European Union: Regulatory Steps En Route to an Integrated Capital Market' (2014) 109 Revista Brasileira De Estudos Políticos p. 109-111
[39] Art. 9(2) of the Takeover Directive
[40] Donato Romano; Stefano Casamassima, European Directive 25/2004/EC and the Rules on Defenses in Takeover Bids, 7 Bocconi Legal Papers 73 (2016) p. 93-94

4.3.2 Competence and Collective action problems of Shareholders

As it relates to the BNR the collective action problem is a problem inherent to collective action by a group of individuals with a common goal whereby there are disincentives that discourage joint action in favour of more individualistic goals.[41] In relation to shareholders, this manifests itself, e.g., in a pressure to accept takeover bids, even if the takeover bid is below the shares real value. However, if the shareholders would have acted in unison, they would be able to get a higher premium for their shares.[42]

The problem of collective action is also apparent when shareholders need to make decisions, and this is especially true in companies with dispersed ownership structures. A minority or a miniscule shareholder might meet the decision-making process with certain apathy as his effect on the outcome of the vote on a decision is diminishing and as such not worth the time needed to stay well informed on all matters relating to it. If in doubt, a minor shareholder might abide by the so-called *Classic Wall Street rule* and simply sell his or her shares and leave the company.[43] By contrast, in block-holder[44] owned companies the controlling party has the incentives to monitor more closely the performance of the management and to take action if the company is underperforming. A block-holder will normally avoid abandoning ship since they have more of a vested interest in the company.[45]

It can therefore be argued that the BNR, by moving the decision-making power from concentrated and highly informed management to a dispersed and disorganised group of shareholders might be detrimental for the company in the long run. The shareholders eyeing, above all else, the shares' market value might focus solely or primarily on short-term investments. The BNR might therefore discourage managements from making long-term investments for the company in favour of the shareholder appeasing short-term

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[41] ——,Collective Action Problem' (Encyclopedia Britannica, 7 March 2013) <https://www.britannica.com/topic/collective-action-problem-1917157> accessed 2 April 2019

[42] Donato Romano; Stefano Casamassima, European Directive 25/2004/EC and the Rules on Defenses in Takeover Bids, 7 Bocconi Legal Papers 73 (2016) p. 89

[43] Kecskés A and Halász V, 'Hostile Takeover Bids in the European Union: Regulatory Steps En Route to an Integrated Capital Market' (2014) 109 Revista Brasileira De Estudos Políticos p. 114

[44] A Block-holder is a shareholder which can exert effective control over a company due to his holdings.

[45] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, The Takeover Directive as a Protectionist Tool? (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 13-15

investments, as they are ultimately accountable to their shareholders, and thus they might be running the company improperly.[46]

4.3.3 Redundancy Argument

4.3.3.1 BNR adds nothing

Many critics of the BNR have argued that before its adoption most Member States already had rules prohibiting management from acting against the company's best interest.[47] Those rules are either a direct substitute to the BNR, requiring shareholder's approval before adopting defensive measures or rules constraining the discretional powers of the management and thus producing similar effects.[48] For example, the 2nd company directive[49] has mandatory shareholder votes regarding certain major decisions regarding a company.[50]

This line of argument has not gone unchecked though and the countering arguments are threefold. First, the BNR is a general rule that covers any action that might frustrate a bid and thus acts as a *catch-all* mechanism while a rule or subset of rules governing certain aspects of possible bid frustration might not anticipate all possible avenues of defensive measures. Second, the BNR is a rule and not a standard and as such is more objective and unambiguous and therefore it is easier to predict outcomes of its use and base claims on its misuse. Lastly, the 2nd company directive allows for a pre-emptive approval by the shareholders regarding, but not limited to, issuing new shares, which can be a powerful defensive mechanism. According to the Takeover Directive however, the BNR applies from the moment the management of an offeree company is made aware of the bidders'

[46] Donato Romano; Stefano Casamassima, European Directive 25/2004/EC and the Rules on Defenses in Takeover Bids, 7 Bocconi Legal Papers 73 (2016) p. 89
[47] Clerc C, Demarigny F, Manuel M de, and Valiante D, '*A Legal and Economic Assessment of European Takeover Regulation*', p. 114
[48] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, The Takeover Directive as a Protectionist Tool? (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 4-5
[49] Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law
[50] Article 82 of the 2nd company directive

intentions and stresses the fact that pre-emptive authorisation is not allowed under BNR and as such adds a second layer of protection for the shareholders. [51]

4.3.3.2 Removal rights render BRN redundant

Another argument made in support of the redundancy of the BNR is that even if there is no BNR or its familiar to speak of, the outcome would still be the same or similar if the shareholders have effective removal rights over management, i.e. governance rights that can effectively replace the BNR. A management would be obliged to behave in a manner that is in interest and to the satisfaction of the shareholders knowing that should they act selfishly, they might very well be replaced by the shareholders.

This argument stands and falls with a particular of a company's' AoA, especially regarding the removal rights of directors, and the constitution of its shareholders. One can, therefore, envisage this being an effective remedy in a block-held owned company rather than a dispersed one due to the aforementioned collective action problems.[52]

4.3.3.3 Market responses to the managerial entrenchment

Lastly, in the line of argumentation that the BNR is redundant, as the same effects can be facilitated in a company's' AoA or through other contractual agreements between the company and its incumbent management are performance-related payment schemes. Such a scheme could ensure that the management and shareholders' interests align by performance-related pay or a handsome severance package (*golden parachute)* in case of a takeover. Different jurisdictions have different approaches to those kinds of dealing and in some, a member of management might be better off staying entrenched in his position rather than taking a severance. Such deals have also been critiqued for rewarding failure as a poorly run company with great potential is a prime takeover target.[53]

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[51] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, The Takeover Directive as a Protectionist Tool? (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 4-7
[52] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, The Takeover Directive as a Protectionist Tool? (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 8-9
[53] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, The Takeover Directive as a Protectionist Tool? (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 9-10

4.3.4 Pre-bid Defences

The BNR only takes effect once a bid or potential bid has been acknowledged in accordance with article 6(1) of the Takeover Directive, i.e. from the time the bid has been made public and the relevant supervisory authority has been notified.[54] A determined management is, therefore, able to make any future takeover bids unfeasible without triggering the BNR. One of the ways for a management to succeed in this manner are so-called *change in control provisions*.

Such provisions are clauses entered into the company's agreements whereby their contractual partner retains the right to terminate the contract should there be a change in management. One can envisage a scenario where such a provision is embedded in a company's most profitable and/or exclusive contracts, should such a contract be terminated following a takeover, the value of the target company might fall considerably. A potential purchaser might think twice about making a takeover bid for a company employing such a provision in its contracts as they introduce much uncertainty and unwanted risk.[55]

The High-Level group of experts recognised this and catalogued the most important barriers of this sort in their report, their solution to the problem was the BTR.[56]

4.4. Transposition

It's impossible to evaluate the success of the Takeover Directive without looking into how well it was received by the Member States as it is apparat that no matter how good a rule is, it will not be able to have any effect if Member states chose not to implement it.

Regarding BNR the Commission, in its report on application of the Takeover Directive has concluded that the BNR is relatively successful having been transposed in 20 Member States.[57] The European Parliament's findings were on par with that of the Commission in

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[54] Art. 9(2) of the Takeover Directive

[55] Donato Romano; Stefano Casamassima, European Directive 25/2004/EC and the Rules on Defenses in Takeover Bids, 7 Bocconi Legal Papers 73 (2016) p. 94-95

[56] The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union, p. 74-75

[57] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012p.3,8 & Krehic T, 'Croatia, Takeover Guide' <https://www.ibanet.org/Document/Default.aspx?DocumentUid=F3C3647A-CFDE-4C7D-8DD4-

its report.[58] Bear in mind that this finding does play to the favour of the redundancy argument put forth in chapter 4.3.3. here above as the BNR was only introduced as a new product of the Takeover Directive in 5 Member States, those being Cyprus, Finland, Latvia, Malta and Romania. For full distribution see appendix[59]

4.5. Preliminary Remarks on the BNR

The BNR, in essence, seems to contribute nothing negative. In a takeover market where all actors would act in good faith the only concern apparent are the collective issues that shareholders face. Which in turn would be mitigated since the management of any given company is obliged to act in the company's best interest. And since such obligation was generally present before the adoption of the BNR it might even be considered redundant.

In praxis however, it is unlikely that all actors would abide by such good sportsmanship. A determined offender, be it the management of the offeror or offeree, have plenty of ways to circumvent the intended effects of the BNR in its current form.

5. Breakthrough Rule

These next sub chapters will expand on the function of the Breakthrough rule as well as its intended objective as well as exploring its critique.

5.1. Function

The rules governing what an offeree company may and may not do during a takeover bid are highly delicate. Two key positions play a game of seesaw, should the offeree company be allowed to defend itself or must it await its fate without intervening. In other words, which should be favoured, the protection of the status quo or the

[58] European Parliament (EU), 'REPORT on the Application of Directive 2004/25/EC on Takeover Bids' A7-0089/2013', 23 March 2013 p,6

[59] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012.p.3,8 & Krehic T, 'Croatia, Takeover Guide' <https://www.ibanet.org/Document/Default.aspx?DocumentUid=F3C3647A-CFDE-4C7D-8DD4-84317484B56D> accessed May 3, 2019, p.2,11

encouragement of competitiveness in the market. As one of the Takeover Directives aims is to facilitate takeovers it is no surprise that the latter was favoured by the European legislators.[60]

In the Takeover Directive, this manifests itself as the breakthrough rule (BTR) found in article 11. According to which, any restrictions on the transfer of shares in the AoA of the offeree company or in contractual agreements between the holders of shares in said company during the time allowed for the acceptance of a bid, in accordance with article 7(1), shall not apply *vis-á-vis* the offeror.[61]

The same applies to restrictions on voting rights during the general shareholders meeting held in concert with the requirements of the BNR regarding the adoption of defensive measures. Furthermore, shares carrying multiple voting rights shall only carry a single vote each. Both restriction rules only apply to shares issued after the adoption of the Takeover Directive.[62]

Furthermore, if an offeror, following a successful bid, holds 75% or more of the capital carrying voting rights, then he is entitled to call for a general meeting of the shareholders. During this first meeting, none of the restrictions above apply following the closure of the bid. Neither shall any extraordinary rights concerning the appointment or removal of members of management and the offeror may alter the AoA or the composition of the management during this meet.[63] The Takeover Directive is however not crystal clear on whether the 75% share of voting capital abides by the *one share one vote* principle (OSOV)[64] or if the total sum of votes is to be used.[65]

Lastly, the BTR does not apply regarding special shares that confer rights on the Member States or where such rights are bestowed upon them according to national law as

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[60] Maura Garcea, 'Takeover Bids European Law and Corporate Governance' *In* Governance and Regulations' Contemporary Issues, p. 148-149
[61] Article 11(2) of the Takeover Directive
[62] Article 11(3) of the Takeover Directive
[63] Article 11(4) of the Takeover Directive
[64] I.e. that each share in a publicly traded company should represent one vote at meetings of the shareholders (One-Share-One-Vote Rule' (TheFreeDictionary.com) <https://financial-dictionary.thefreedictionary.com/One-share-one-vote+rule> accessed 4 April 2019.)
[65] [65] Kecskés A and Halász V, 'Hostile Takeover Bids in the European Union: Regulatory Steps En Route to an Integrated Capital Market' (2014) 109 Revista Brasileira De Estudos Políticos p. 119

long as they are compatible with community law, these are called *Golden shares.*[66],[67] Nor does it apply when restrictions on voting rights are supplemented by specific pecuniary advantages.[68]

5.2. Reasoning

The High-level group did not consider that the BNR was enough to ensure that the principle of proportionality between the risk-bearing capital and control of a company was adhered to once a bid had been made public. They pointed out that if the company structure deviated from the OSOV principle the disproportionate control rights might be used to go against the will of the majority of the shareholders, e.g. by allowing the management to frustrate a bid under the procedure provided for by the BNR. The BTR, by enacting the OSOV principle would make sure that defensive measures would only be adopted whereas a true majority of shareholders were behind the decision and thusly, guaranteed proportionality between risk and control.[69]

If the BTR would not apply it could surmount to a serious hindrance to the promotion of a well-functioning takeover market in the European Union as a small group of owners would be able to maintain all or most control over companies and thereby rendering hostile takeovers improbable or even impossible.[70]

The High-level group also recommended that following a successful bid, whereby the offeror managed to acquire 75% or more of the capital carrying voting rights, the offeror would be allowed to 'breakthrough' any defensive mechanism liable to frustrate the exercise of proportionate control (i.e. OSOV). The High-level group argued that company structures still vary greatly within the European Union and this would allow those differences to remain intact without deterring takeover bids in Europe.[71] That is why an

[66] Dhir R, 'What Makes a Golden Share?' (*Investopedia*) <https://www.investopedia.com/terms/g/goldenshare.asp> accessed 4 April 2019.
[67] Article 11(7) of the Takeover Directive
[68] Article 11(6) of the Takeover Directive
[69] The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union, p. 28-29
[70] Kecskés A and Halász V, 'Hostile Takeover Bids in the European Union: Regulatory Steps En Route to an Integrated Capital Market' (2014) 109 Revista Brasileira De Estudos Políticos p. 120-123
[71] The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union, p. 29-30

offeror may follow a successful takeover bid by calling a general meeting of shareholders in order to make the necessary changes to the AoA or appoint/remove directors from management to ensure that actual control over the company resides with the offeror.[72]

5.3. Controversial Issues

5.3.1 Golden Shares

At present, the BTR is fundamentally concerned with private law relations and its effects are considerably narrowed by excluding restrictions set forth by national law.[73] The High-level group recommended that the BTR should indeed apply to *Golden Shares* as well as they could find no justification for distinguishing between companies in which control enhancing mechanisms (CEM) were held by private persons to that, where such rights were held by a Member State.

Golden Shares are e.g. very common in formerly state-owned companies, but the High-level group argued that if such an enterprise should seek the benefits of privatisation, they should also abide by the same rules as other private companies on the market. If a Member State wished to retain control over a company for legitimate public interest reasons, they should do so through legislation to that effect which would be subject to public law principles.[74] The fact that *Golden Shares* are common in some member states, like France and Portugal, while other Member States tend not to use them further supports their illegitimacy. Member States making use of *Golden Shares* thus have an unfair advantage on a takeover market which the Takeover Directive seeks to harmonize.[75]

The reason that state held CEM like *Golden Shares* are not under the scope of the Takeover Directive is sadly a political compromise due to the fact that the Member States did not feel secure in relinquishing control of certain enterprises they deemed too valuable

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[72] Donato Romano; Stefano Casamassima, European Directive 25/2004/EC and the Rules on Defenses in Takeover Bids, 7 Bocconi Legal Papers 73 (2016) p. 81-82

[73] [73] Kecskés A and Halász V, 'Hostile Takeover Bids in the European Union: Regulatory Steps En Route to an Integrated Capital Market' (2014) 109 Revista Brasileira De Estudos Políticos p. 123-124

[74] The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union, p. 34

[75] Dimity Tuchinsky, 'The Takeover Directive and Inspire Art Revaluating the European Union's Market for Corporate Control in the New Millennium, p. 708

to the national interest of their respective states.[76] The Member States don't have a complete *carte blanche* in this aspect however, as they have to abide by the TFEU, especially the provisions relating to freedom of capital flow and establishment. [77]

As Peter Werdmuller pointed out in his paper 'compatibility of the EY takeover Bid Directive Reciprocity Rule with EU Free movement rules', The ECJ has, in its jurisprudence, has established that for a *Golden Share* CEM to be permissible under the treaties they have to be; (I) non-discriminatory, (II) justified by overriding requirements of public interest and (III) suitable and proportionate to achieve that objective.[78]

5.3.2 Pyramid structures and cross-shareholdings

The BTR fails to capture the two of the most powerful CEM used to distort the balance between cash and control (OSOV), *pyramid structures* and *cross-shareholdings*.[79]

In a pyramid structure, a minority shareholder in a company subject to a bid holds a controlling stake in another company which, depending on how many tiers the structure has, holds a controlling stake in the company that is the subject of a takeover.[80]

Cross-shareholdings are when two companies hold a minority stake in each other and can thus aid one another in case they become the object of a takeover attempt. This ownership form is often used to interlock further companies that already sustain an amicable business relationship.[81]

The High-level group recognised the imposition posed by these structures but alas decided against recommend that the Takeover Directive would cover them. They believed that the application of such would be both expensive and potentially impossible. If the BTR would be applied to the structure as a whole a bidder would need to expand his bid to some

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[76] Michel M, 'The European Regime on Takeovers' (2006) 3 European Company and Financial Law Review 222-236. P. 230-231.
[77] Peter Werdmuller, 'Compatibility of the EU Takeover Bid Directive Reciprocity Rule with EU Free Movement Rules' (2006) 27 Business Law Review, Issue 3, pp. 66-67
[78] Peter Werdmuller, 'Compatibility of the EU Takeover Bid Directive Reciprocity Rule with EU Free Movement Rules' (2006) 27 Business Law Review, Issue 3, pp. 66-67
[79]Clers C, *A Legal and Economic Assessment of European Takeover Regulation* (Centre for European Policy Studies 2012) p. 184-185
[80] Bebchuk LA, Kraakman RH, and Triantis GG, 'Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights' [1999] SSRN Electronic Journal. P. 4-5
[81] Kenton W, 'Cross Holding' (Investopedia) <https://www.investopedia.com/terms/c/cross-

holding.asp> accessed 6 April 2019.

extent, to include capital in some of the holding companies with the associated cost increase.[82]

The fact remains that by setting aside these corporate structures a loophole has been created and companies wishing to escape the BTR can simply reorganise into pyramid structures or cross holdings, this hypothesis is backed up by empirical evidence of what happened in Belgium following the OSOV principle where an increase of pyramids was noticed.[83] A study from 2012 undertaken on the subject, found that around 18% of companies in the European Union had pyramid structures while roughly 2% deployed cross-holdings. It shows that while cross-holdings may not be a cause for concern, pyramid structures are quite popular in the European Union.[84]

As pyramid structures fulfil the very same purpose the BTR was set afoot to break up, i.e. that block holders attain more power through CEM than they are titled to under the OSOV principle, it's difficult to justify how selective the Takeover Directive is. The biggest obstacle for rectifying this remains what solutions are available. The US has since the 1930s introduced a double tax scheme on inter-corporate dividends, for example. The creation of incentives through taxation might thus prove fruitful but this requires further research.[85] Worth noting is that this was also what the High-level group considered the right course of action.[86]

5.3.3 Principle of shareholder decision-making

The application of a mandatory BTR goes against the principle of shareholder decision-making. The BTR overrides provisions of the AoA and agreements between shareholders on how voting rights are exercised or the transfers of shares are governed.[87]

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[82] The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union, p. 39
[83] Clers C, *A Legal and Economic Assessment of European Takeover Regulation* (Centre for European Policy Studies 2012) p. 81
[84] Clers C, *A Legal and Economic Assessment of European Takeover Regulation* (Centre for European Policy Studies 2012) p. 84
[85] Clers C, *A Legal and Economic Assessment of European Takeover Regulation* (Centre for European Policy Studies 2012) p. 185
[86] The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union, p. 39
[87]Kecskés A and Halász V, 'Hostile Takeover Bids in the European Union: Regulatory Steps En Route to an Integrated Capital Market' (2014) 109 Revista Brasileira De Estudos Políticos p.123

For advocates of both the BNR and BTR this line of argument cuts particularly deep as the same principle of shareholder decision-making is often used to validate the existence of the BNR.[88]

5.4. Transposition

The BTR is vastly passed over by the Member States having only been transposed in 3 countries, Estonia, Latvia and Lithuania. At the time of the Takeover Directive's adoption there where hopes that despite the optionality of the BTR, that shareholders might push for it to be applied voluntarily in their respective companies by making use of article 12(2) of the Takeover Directive. However, this seems not to have been the case. [89] Full table listing the transposition of the BTR can be found in the appendix.

5.5. Preliminary Remarks on the BTR

The BTR seems noble enough, making sure that once a new owner takes control over a company they truly are in control. Making it harder for pockets of resistance within the shareholders body being able to frustrate or even prevent a bid. However, the fact that it is so easily escapable by converting to a pyramid structured company really weekends its constitution. A predatory company, prone to hostile takeovers, would simply make sure it's pyramid structured and then be free to pursue more docile companies that have not had the foresight or capabilities to restructure. These concerns are furthermore voided in light of how badly the BTR was transposed as it Is only mandatory in 3 minor economies in the EU. Couple that with the fact that the High-level group seem to have meant the BTR and BNR to complement each other, then the failure of the BTR must reflect poorly upon the BNR[90]

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[88] Clers C, *A Legal and Economic Assessment of European Takeover Regulation* (Centre for European Policy Studies 2012) p. 81

[89] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012. p.3,8 & Krehic T, '*Croatia, Takeover Guide*' <https://www.ibanet.org/Document/Default.aspx?DocumentUid=F3C3647A-CFDE-4C7D-8DD4-84317484B56D> accessed May 3, 2019, p.2,11

[90] The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union, p. 74-75

6. Reciprocity and Optionality

Though not specified as the topic primary of this paper article 12 of the Takeover Directive plays such an intrigued role with the BNR and BTR that it much be examined in order to come to any kind of rational conclusion regarding a level playing field.

6.1. Function

The reciprocity rule enshrined in article 12 of the Takeover Directive is in a sense trifold, but its namesake derives from the third paragraph of article 12. First, it allows Member States to decide if they wish to make the BNR and/or the BTR mandatory for the companies registered in their jurisdiction.[91] Second, should a Member state decide to make the rules nonmandatory, a company may nonetheless decide to adopt the BNR and BTR on its own accord.[92] Third, a Member State may exempt companies that abide by either or both the BNR and BTR from applying them should said company become subject to a bid by a company that is not constrained by those same rules.[93]

It's worth noting that the decision to opt in or out of the reciprocity rule, where such leeway is given to a company, must be decided at a general meeting of the shareholders at least 18 months prior to the launch of a bid.[94]

A Member State thus has some alternative options when it comes to implementation of article 12 into the national legislation which may be summarised as follows: I. a Member State may refuse to adopt either or both the BNR and BTR while providing companies the discretion to choose themselves if they want to follow the provisions. II. Adopt either or both rules but make their application contingent upon reciprocity, i.e. the rules shall not apply in case of a bidder that is not subject those same rules. III. Lastly, a Member State may choose to adopt either or both rules without any reciprocity requirements.[95]

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[91] Article 12(1) of the Takeover Directive
[92] Article 12(2) of the Takeover Directive
[93] Article 12(3) of the Takeover Directive
[94] Article 12(5) of the Takeover Directive
[95] Ventoruzzo M, 'Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political Economic Ends' 41 TEXAS INTERNATIONAL LAW JOURNAL 53. P. 211-213

6.2. Reasoning

The introduction of the reciprocity rule into the Takeover Directive was meant to alleviate some of the concerns that Member States had regarding the strictness of the BNR and BTR, especially when an EU company is subject to a bid from a third country company, namely from the US. Without reciprocity, a US based company might gain an unfair advantage over their European counterparts since they'd have an arsenal of takeover defences at their disposal while the Takeover Directive binds the hands of those that fall within its dominion.[96]

Had the Takeover Directive been adopted without containing the reciprocity rule it is hard to imagine that Member States would have had any real incentive to transpose the BNR and BTR, given that their implementation would have remained optional.

6.3. Controversial Issues

As previously stated, some of the goals set out to achieve by the directive were to facilitate takeover *inter alia* by levelling the playing field and to enhance legal certainty in the conduction of takeover bids. However, when dealing with article 12 of the Takeover Directive those two goals seem somewhat at odds.[97]

Thus, by introducing the optionality of the pre and post bid defences rules (BNR & BTR) the uniformity of takeover regulations in Europe is drastically hampered and by way of doing so, could result in further fragmentation and increase the chances of unfair advantages. The reciprocity rule somewhat mitigates this risk by allowing an offeree company to respond in kind to an offeror not bound by the rules and thus levelling the playing field. The reciprocity rule is however not without fault as when the rules on optionality and reciprocity are read in unison they might add to legal uncertainty.

Imagine a situation where Member State A chooses to apply both the BNR and the BTR to companies within its jurisdiction without invoking article 12. Member State B,

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[96] Dimity Tuchinsky, 'The Takeover Directive and Inspire Art Revaluating the European Union's Market for Corporate Control in the New Millennium', p. 707-709

[97] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012., p. 2

however, invokes article 12 but opts out of the BNR and BTR. As a result, a company bound by legislation of Member State B would be able to hinder a bid from a company in Member State A with ease while if the roles were reversed the company in Member State A would only be able to frustrate the bid following approval from its shareholders, with the accompanying time delay and costs associated with such approval. This, amongst other issues, has sparked considerable debate regarding the existence and function of article 12. The ongoing convoluted debate has critiqued some of the more ambiguous focal points of the reciprocity rule that shall now be addressed in turn. [98]

6.3.1 Circumvention

The reciprocity rule is not definitive and there are ways to escape its grasp. One way for Member States to do so is by partially deferring from it. As the CEPS report on the Takeover Directive from 2012 shows, some jurisdictions have chosen to transpose the directive in a more lenient manner while also considering that measures that have equivalent effects to the BTR and BNR suffice to pass the reciprocity rest.[99]

Another possible circumvention is by way of using a subsidiary of an offeror company to launch a bid to an offeree company. One can envisage a scenario where a parent company that is not subject to the BNR and/or BTR but retains an economic interest in the outcome of an acquisition of a certain company that is governed by those rules uses its subsidiary[100]or the equivalent, which is bound by either or both the BNR and BTR, to launch a bid.[101]

By way of doing so the offeree company would not be able to set aside the BNR or BTR on the grounds of reciprocity and thus make the acquisitions considerably more effortless. Its largely unclear whether or to what extent national supervisory bodies monitor these shrouded economic interests or the entity behind a transaction that stands to gain from

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[98] Dimity Tuchinsky, 'The Takeover Directive and Inspire Art Revaluating the European Union's Market for Corporate Control in the New Millennium', p. 707-709

[99] Clerc C, Demarigny F, Manuel M de, and Valiante D, 'A Legal and Economic Assessment of European Takeover Regulation', p.176

[100] Given that the subsidiary is or seemingly is distant enough, as defined by article 22 of Directive 2013/34/EU from the parent not to trigger article 12(3) of the Takeover Directive.

[101] Clerc C, Demarigny F, Manuel M de, and Valiante D, *'A Legal and Economic Assessment of European Takeover Regulation'*, p.176

its outcome, but it is clear that the potential for circumvention in such a manner is most assuredly detrimental to the objectives set out by the reciprocity rule.[102]

6.3.2 Multiple bidders

Another important interpretative uncertainty regarding the reciprocity rule arises when a target company is faced with multiple bids, from companies that abide by a different subset of the BNR and BTR rules than the target itself. Is the target company free to apply the reciprocity rule against all the bidders or just the ones that trigger the clause in regard to the target company?[103]

Take for instance an example whereby Member State A makes the BNR and BTR mandatory but also applies the reciprocity rule and Member State B, that does not impose the BNR or BTR on companies in its jurisdiction. Target company X situated in Member State A, that has been granted the power by its shareholders to invoke reciprocity in accordance with article 12(5) of the Takeover Directives, then becomes subject to two hostile takeover bids, one from company Z from Member State A and company Y from Member State B. Company X would not be able to mount defences without a prior shareholder approval in respect to company Z, but by making use of the reciprocity rule would not be forced to uphold the BNR and BTR against company Y.[104] This may create a tilted playing field rather than a level one, resulting in a partial auction which is likely to be detrimental to offeree companies' shareholders and to discourage bids.[105]

The France legislator has taken the stance that in such a case defensive measures may be taken against all the bidders in question while other national legislators have remained ambiguous regarding the matter.[106] If the French view is faulty the example above seems to strike entirely true which would go against some of the goals set out by the

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[102] Clerc C, Demarigny F, Manuel M de, and Valiante D, 'A Legal and Economic Assessment of European Takeover Regulation', p.176
[103] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, 'The Takeover Directive as a Protectionist Tool?' (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 23
[104] Dimity Tuchinsky, 'The Takeover Directive and Inspire Art Revaluating the European Union's Market for Corporate Control in the New Millennium', p. 709
[105] Dimity Tuchinsky, 'The Takeover Directive and Inspire Art Revaluating the European Union's Market for Corporate Control in the New Millennium', p. 709
[106] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, 'The Takeover Directive as a Protectionist Tool?' (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 23

directive. Namely, legal certainty and the facilitation of takeover bids by way of levelling the playing field and the reinforcement of the single market.[107]

6.3.3 Possible misuse

Where national companies have the opportunity, provide for by article 12 of the Takeover Directive, to opt in or out of the BNR and the BTR there may be created a strong incentive for companies to misuse those the provisions of the Takeover Directive. Companies might find themselves in a situation where they are not subject to the BNR and the BTR and are thus free to deploy defensive measures they see fit. Then at a later stage, when the said company seeks to carry out an acquisition, it will be able to subject itself to the rules just in time to launch a takeover bid. The acquisition target would, therefore, be unable to use the reciprocity rule in order to mount defences against the offeror making the acquisition easier and more cost-efficient. Then, following a successful tender bid the company could simply opt out of the BNR and BTR again and therefore be able to protect itself against future acquisition attempts. If the purpose of the reciprocity rule is to create a level playing field in the takeover space, this distortion seems to be counterproductive to that end.[108]

6.4. Transposition

In regard to the Reciprocity rule in article 12(3) of the Takeover Directive, 13 Member States have chosen to transpose it into national law. Even though it has only been transposed by less than half the Member States it may not be disregarded just yet. It is favoured by most of the bigger economies (excluding UK) in the Union. Perhaps because those Member States are acutely aware of outsider competition and don't want their national champions to stand on an unequal footing. In the appendix there is a table

[107] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012 p.3,8 & Krehic T, 'Croatia, Takeover Guide' <https://www.ibanet.org/Document/Default.aspx?DocumentUid=F3C3647A-CFDE-4C7D-8DD4-84317484B56D> accessed May 3, 2019.p.2

[108] Donato Romano; Stefano Casamassima, 'European Directive 25/2004/EC and the Rules on Defenses in Takeover Bids', 7 Bocconi Legal Papers 73 (2016) p. 92-93

displaying how each individual Member State has opted to transpose the optional provisions of the Takeover Directive.[109]

7. Conclusion

This chapter aims to highlight what, in the authors' humble opinion, are currently the faultiest aspects of the rules explored in this paper and their transposition into national law. Each will be examined in turn and suggestions for modification to the current status quo offered, based on experts' opinions and my own intuition. Matters will be wrapped up with general concluding remarks.

7.1. Regarding the Board Neutrality rule

The strongest arguments made against the BNR are, in my opinion, that it adds nothing to the pre-existing legal systems. In a system without the BNR it's very unlikely that there are no restraints at all on defensive measures as the core duty of loyalty on management to act in the best interest of the company generally is present.[110] To further support this claim one only needs to look at the fact that out of the 20 Member States that transposed the BNR, it was only a new doctrine in 5 of them[111]. However, the BNR is not just a pledge placed on management but a rule which makes it easier to base right on and is generally broader than previous measures as it covers all actions likely to frustrate a bid, even one that previous restrictions could not have envisaged.[112]

Since the BNR, at worst adds nothing to Union law that was not already present and at best facilitates a more fluent takeover market in the Union, I find no reason to contest the

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[109] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012 p.3,8 & Krehic T, 'Croatia, Takeover Guide' <https://www.ibanet.org/Document/Default.aspx?DocumentUid=F3C3647A-CFDE-4C7D-8DD4-84317484B56D> accessed May 3, 2019, p.2,11

[110] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, 'The Takeover Directive as a Protectionist Tool?' (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 4

[111] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, 'The Takeover Directive as a Protectionist Tool?' (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 36

[112] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, 'The Takeover Directive as a Protectionist Tool?' (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p.4-7

existence of the BNR in its current form. However, in order to obtain maximum homogeneity, it should be made mandatory as long as the reciprocity rule is still in effect and thus prevent unfair advantages to jurisdictions outside the EU mandate, not employing the BNR.

7.2. Regarding the Breakthrough rule

The BTR was an ambitious attempt that sadly must have been considered a blatant failure. The fact that it has only been transposed by 3 Member States speaks volumes to that.[113] Even if it would have been met with much greater success in its transpositions there are critical flaws that would still hinder its effectiveness.

First, it seems that not all shares are created equal as the BTR does not cover *golden shares*, their exclusion from the BTR is definitely due to resistance by the Member States which did not want to relinquish control of companies they held essential.[114] This seems a 'have your cake and eat it to' situation as the High-level group pointed out that should Member States wish to keep a controlling interest in such companies they should do so under national law and keep those companies under public law rather than trying to reap the benefits of privatisation without adopting the rules applicable in private law to the fullest.[115]

Second, the fact that the BTR is easily circumvented by simply reorganizing the corporate structure of a company into a pyramid weakens its effect immensely. A loophole has thus been created which is more likely to be abused by larger, predatorial companies capable of restructuring, this is further supported by the Belgium example where an increase in pyramid structures was noted when the OSOV principle was more firmly

[113] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012 p.3,8
[114] Michel M, 'The European Regime on Takeovers' (2006) 3 European Company and Financial Law Review 222-236. P. 230-231
[115] The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union, p. 34

applied.[116] The fact that approximately 20% of the companies in the European Union would be exempted by this rule seems to be too large of a margin to overlook.[117]

Lastly, it seems at odds to use the principle of shareholders decision making as justifications for the BNR and then disregard it when applying the BTR. As the BTR overrides the AoA and agreements between shareholders in case of a successful takeover.[118]

I would not recommend abolishing the BTR all together though, instead its adoption should be taken on the company level, rather than the national one. If companies would choose to do so, they could adopt the BTR of their own free will, which would elevate some of the concerns regarding the shareholder decision making principle.

Furthermore, should this become reality there would be less diversity at the national level in the European Union resulting in a more homogeneous takeover market, at least at the state level. There just does not seem to be enough incentive for Member States to subject their companies to the BTR while it's so widely disregarded in other jurisdictions since that would result in companies in their own jurisdiction to become an easier target for companies not bound by the BTR.

7.3. Regarding the Reciprocity rule

The Reciprocity rule was an ingenious addition to the Takeover Directive as it is hard to see that the directive would ever been adopted into the fold without it, giving the initial push back to its previous proposals.[119] The fact that it has only been transposed by 13 Member States seems odd as there seem to be no downsides to its implementation, quite on the contrary, the reciprocity allows companies within a jurisdiction enforcing it, a final line

[116] Clers C, *A Legal and Economic Assessment of European Takeover Regulation* (Centre for European Policy Studies 2012) p. 81
[117] Clers C, *A Legal and Economic Assessment of European Takeover Regulation* (Centre for European Policy Studies 2012) p. 84
[118] The High-Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union, p. 2, 27,28
[119] Clers C, '*A Legal and Economic Assessment of European Takeover Regulation'* (Centre for European Policy Studies 2012) p. 1-2

of defence against companies from other jurisdictions that have somewhat more lenient laws on takeover defences permitted.[120]

The reciprocity rule is not without its flaws though and I would recommend two alterations to it in its current form. First, regarding article 12(2), which allows companies to opt into the BNR and BTR should the Member State, where they are situated, decide not to impose those rules as mandatory. Due to the collective action problem that shareholders face, modern theory has favoured that by default rules should be constructed to counteract this coordination problem. So, in a situation as above, companies should be automatically opted into the BNR and BTR, then the burden should fall to the management to convince the shareholders to secure an opt-out.[121]

Second, in order for a company to make use of the reciprocity rule in case of a bid by a company not governed by the same rules (article 12(3)) it must have been granted the permission to do so by a general meeting of the shareholders at least 18 months prior to the publication of the bid (article 12(5)). The Takeover Directive is however, mute about any such restrictions applying to the company launching such a bid. It would seem only fitting that the offeror would be subject to similar restrictions in order to limit and deter abusive behaviour. This might be accomplished by adding that the reciprocity rule should only be applicable if the offeror has been subjected to those same, or the equivalent of, for at least 18 months prior to the bid.[122]

Following the recommended amendments above, the reciprocity rule should furthermore be made mandatory. With the safeguards above to prevent abuse, the rule will give Member States more incentives to transpose into national law the BNR and BTR as

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[120] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012 p. 3,8 & Krehic T, 'Croatia, Takeover Guide' <https://www.ibanet.org/Document/Default.aspx?DocumentUid=F3C3647A-CFDE-4C7D-8DD4-84317484B56D> accessed May 3, 2019, p.2,11

[121] Davies, Paul L. and Schuster, Edmund-Philipp and van de Walle de Ghelcke, Emilie, 'The Takeover Directive as a Protectionist Tool?' (February 17, 2010). ECGI - Law Working Paper No. 141/2010. p. 27

[122] Donato Romano; Stefano Casamassima, 'European Directive 25/2004/EC and the Rules on Defenses in Takeover Bids', 7 Bocconi Legal Papers 73 (2016) p. 93

companies in their jurisdiction would be protected against takeover attempts made by companies in other jurisdictions that aren't bound by the BNR and BTR.

7.4. Concluding Remarks

Should the author of this paper be granted omnipotence for a day the both BNR and BTR would be made applicable at a national level while at the company level there remained an opt-out option should companies so wish. They would then have to convince their shareholders that such course of action would be in their best interests. The reciprocity rule would also be made mandatory in the suggested form here above. This would ensure that all companies in the European Union would have the same starting position (level playing field) and any discrepancies would be the result of their own free will in keeping with the principle of shareholder decision making. Companies would thus have to stand or fall by their own policy makings rather than that of the Member State they happen to be situated in.

However, this might all be moot as even though that the BNR could be considered a success by the Commission in its report on the application of the Takeover Directive from 2012, it found that its adoption had not led to major changes in the legal framework of the Member States.[123] Furthermore, the same report shows that the Takeover Directive has not led to a significant increase in takeover bids and that shareholders have expressed the view that there are still enough possibilities to break through takeover defences even though the BTR was so poorly transposed into national law.[124]

Even though the Commission, at the time, did not recommend further action in regard to the optional provisions of the Takeover Directive, one has to bear in mind the economic climate of the time. Europe was far from immune to the financial crisis of 2008

[123] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012. p.3
[124] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012. p.4,8

so it's unsurprising that a report from 2012 did not disclose a significant increase in takeover bids since takeovers are heavily dependent on the availability of capital. Should another evaluation take place in the current markets they might sing a different tune.[125]

Regardless, by opting the proposed changes I believe that a much more level playing field would emerge following the changes compared to the present state. And importantly, any deviations would be taken the companies themselves rather than being mandated by the authorities. Should the shareholders find themselves in a corporate structure with discrepancies to the OSOV as a result from this allotted freedom at least they'd entered into it of their own volition.

[125] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012. p.4

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10. Appendix

Distribution table, displaying how each individual Member State has opted to transpose the optional provisions of the Takeover Directive.[126]

Country/Transposition	Mandatory BNR	Mandatory BTR	Reciprocity Rule
Austria	**yes**	no	no
Belgium	no	no	**yes**
Bulgaria	**yes**	no	no
Croatia	**yes**	no	no
Cyprus	**yes**	no	no
Czech Republic	**yes**	no	no
Denmark	no	no	**yes**
Estonia	**yes**	**yes**	no
Finland	**yes**	no	no
France	**yes**	no	**yes**
Germany	no	no	**yes**
Greece	**yes**	no	**yes**
Hungary	no	no	**yes**
Ireland	**yes**	no	no
Italy	**yes**	no	**yes**
Latvia	**yes**	**yes**	no
Lithuania	**yes**	**yes**	no
Luxembourg	no	no	**yes**
Malta	**yes**	no	no
Netherlands	no	no	**yes**
Poland	no	no	**yes**
Portugal	**yes**	no	**yes**
Romania	**yes**	no	no
Slovakia	**yes**	no	no
Slovenia	**yes**	no	**yes**
Spain	**yes**	no	**yes**
Sweden	no	no	no
United Kingdom	**yes**	no	no

[126] Commission (EU), 'Report from the Commission to the European Parliament, the council, the European economic and social committee and the committee of the regions, Application of Directive 2004/25/EC on takeover bids' COM (2012) 347 final, 28 June 2012. & Krehic T, '*Croatia, Takeover Guide*' <https://www.ibanet.org/Document/Default.aspx?DocumentUid=F3C3647A-CFDE-4C7D-8DD4-84317484B56D> accessed May 3, 2019, p.2,11